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REITs: A NEW PROPERTY DIMENSION TO ISLAMIC FINANCE

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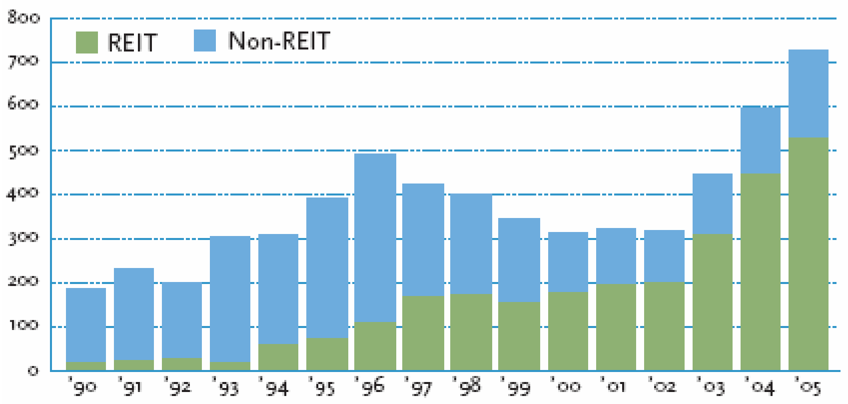
Abstract: *Published evidence on the performance of PTFs (Property Trust Funds) in Malaysia is very limited (e.g., Kok and Khoo, 1995; Ting, 1999; Newell, Ting and Acheampong, 2002; Rozali and Hamzah; 2006). With significant results from previous research, various efforts has been taken to improve the performance of the Malaysian REIT market including continuous regulation reforms, high quality real estate acquisitions and the development of competitive investment products (i.e. Islamic REIT). However, a review and performance analysis of Malaysian REITs has not yet been discussed. This paper aims to discuss whether these efforts have resulted to in increased stature and performance of the Malaysian REIT industry.*

INTRODUCTION

Recent years have seen an increase of interest in REITs at a global level; particularly amongst global property securities fund. Globally, REITs are developing rapidly with the number of REITs growing significantly. It has a current market capitalisation of more than US$600 billion (see Figure 1).

Figure 1: Growth of Global REITs (as of December 31, 2005)



Source: UBS Investors Index.

Of this, the Asian property market has the strongest growth prospects compared to other regional property markets, following wider market acceptance and increasing attention from institutional investors. Since 2001, more than 70 REITs have been listed in Japan, Singapore, Hong Kong, South Korea, Malaysia, Taiwan and Thailand. The total market capitalisation of the REIT sector in Asia is approximately US$47 billion, with more REITs concurrently being created. Regulatory reform has been made particularly by Singapore and Hong Kong regulators to enhance their REIT competitiveness in Asia. For a comparison with other Asian countries, Figure 2 shows the listed REITs in Asia.

Figure 2: Asian Listed REITs/Property Funds as at end April 2006

Market	Stock Market indices	Stock index change from Oct 2005	No. of listed REITs	Dividend Yield	10-yr govt bond yield	REIT Market Cap (US$ Million)
Japan	16,906.23	24.25%	32	4.1% (avg)	1.85%	30,060
Singapore	2,610.71	17.77%	10	5.0% (avg)	3.46%	8,680
Hong Kong	16,661.30	15.81%	3	3.6%-6.3%	4.80%	5,480
S. Korea	1,419.73	22.59%	7	8.7% (avg)	5.30%	700
Taiwan	7,171.77	24.42%	4	3.7%-4.6%	2.06%	1,280
Thailand	768.29	12.55%	8	7.1% (avg)	5.51%	560
Malaysia	949.23	4.22%	7	6.6% (avg)	4.30%	590

Source: CB Richard Ellis, company announcements/ prospectus.

As of April 2006, there are 3 PTFs and 4 REITs in Malaysia with the market capitalisation of US$590 million. Malaysia has pioneered in the development of Islamic REITs. The Al-'Aqar KPJ

REIT, the world's first Islamic REIT, was listed in the KLSE on 10 August 2006. This has been seen as a good development as it broadens and deepens the market for REITs and ethical investing in Asia. It is believed that unethical investment products contribute negative impacts to the environment. Moreover, Muslim investors tend to be attracted to enterprises observing Islamic ethical and moral standards.

This paper examines Islamic REITs in Malaysia as one of the latest investment vehicles compared to the conventional REITs in Malaysia. The aims of this study are to determine:

1. The significance of Islamic REITs as an investment vehicle.
2. Performance analysis of Islamic REITs in Malaysia.
3. The problems and challenges they will face.
4. Islamic REIT prospects.

The results show that Islamic investment products are likely to see significant future growth in many countries. With the introduction of Islamic REITs, it is likely that the Islamic compliant property market is poised to become significant within the global financial markets. Today, Islamic financial institutions are advancing and improving their products to attract more diversified investors, with Islamic REITs expected to play an important role.

DEVELOPMENT OF CONVENTIONAL REITs IN MALAYSIA

Malaysia is the first Asian country to develop a REIT market. It was better known as PTFs in 1986. Malaysia used the Australian LPT model to set up the regulatory framework although there are some different aspects to the structure. This is mainly because of the 'bumiputra' rules which restrict foreign ownership in favour of indigenous Malays. The first regulatory framework was approved by Bank Negara Malaysia (the Central Bank of Malaysia) with the principal governing their establishment and operation being the Companies Act 1965 and the Securities Industry Act 1983 (Rozali and Hamzah, 2006). Later, the Securities Commission (SC) became the regulator once it was formed. Specific Guidelines on PTF were introduced by SC in 1991 and later revised in 1995 and 2002.

Unfortunately, since 1989 till 2004, the PTF industry performed poorly (Ting 1999; Newell, Ting and Acheampong, 2002). The regulatory structure was still restrictive. During these periods, only subsidiaries companies of financial institutions were permitted to set up and manage such funds. In 2004, only 3 PTF were listed in the Kuala Lumpur Stock Exchange (KLSE) namely; AmFirst Property Trust (AMFPT), Amanah Harta Tanah PNB (AHP) and Amanah Harta Tanah PNB 2 (AHP2). Other factors which have contributed to the poor performance of PTFs were lack of prime properties and quality assets in their property portfolios. Even with the availabilities of these properties, the borrowing limits and the long acquisition period have depleted the interest to the parties involved (i.e. investors and property owners).

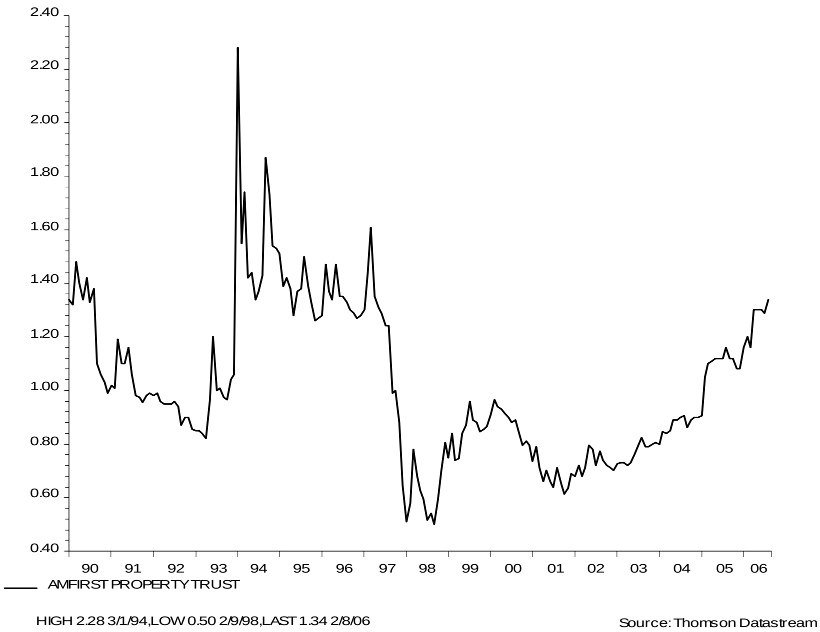
Since it's first listing, the price for AMFPT performed better in comparison with other PTFs. Figure 3 presents the PTFs performance since IPO. Even during the Asian financial crisis in 1998, the trust was able to sustain with the lowest price of 50 sen which is higher than other PTFs in the same period. Figure 4 indicates the movements of price change of AMFPT trust. It appears that the source of this steady income was mainly generated from both of their highly occupied buildings in Kuala Lumpur, AmBank Group Building and AmBank Group Leadership Centre.

Figure 3: PTFs performance since IPO (as of 31 August 2006)

	IPO Price (RM)	Current Price (RM)	Change in Share Price (%)
AMFPT	1.34	1.35	1
AHP	1.18	0.74	-44
AHP2	1.39	0.42	-97

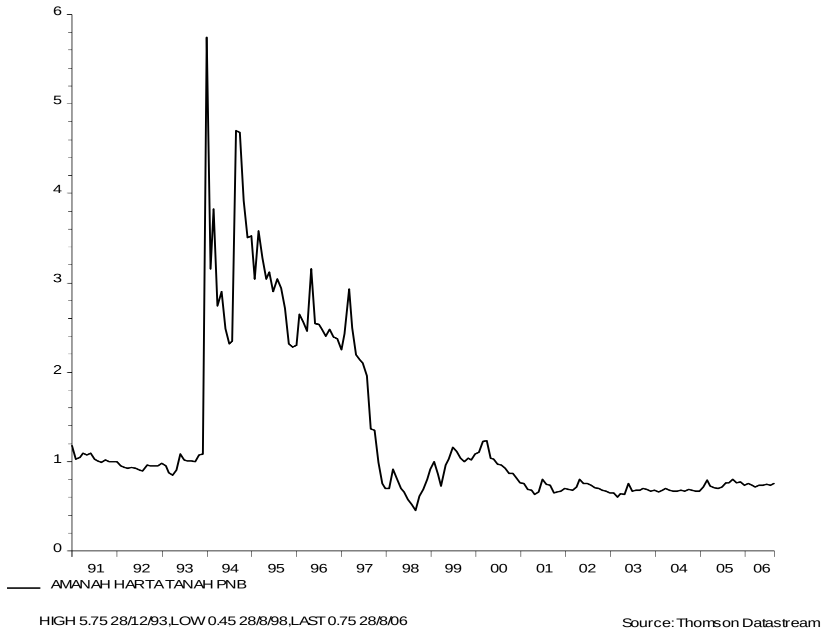
Source: Datastream and author's compilation.

Figure 4: AMFPT share price movement (Base date = 2 January 1990)



Meanwhile, difficulties in acquiring prime properties have resulted AHP trust to expand their property portfolios with non-prime or small properties e.g. shop offices, shop houses and secondary buildings. In 1994, the stock market witnessed a record-breaking bull run. Figure 5 reflects the performance of AHP having the highest share price of RM5.75 in 1994. However, the share price performance has been subdued as a result of short in quality assets which is then associated with investor's lack in interest.

Figure 5: AHP share price movement (Base date = 28 December 1990)



These factors have also hindered the performance trust of AHP2. Figure 6 presents the share price movements of AHP2. The highest share price was during its first day listing which is then appears to fall much further during the Asian Financial crisis. Until the first half of 2006, the trust managers were still having difficulties to improve the occupancy level of their property in Ipoh, Perak which is 29.69%. As at August 2006, the share price is the lowest since it was listed which recorded only 38 sen.

Figure 6: AHP2 share price movement (Base date = 25 March 1997)

The poor performances of Malaysian PTFs together with the successful development of REIT-like structures in other countries (e.g. Australia and US) have encouraged government and regulators to enhance the existing PTF framework. In the 2005 budget, the Malaysian Government introduced further improvements to its REIT-like structure which included a more tax transparent structure. However, the tax transparency in Malaysia is not as attractive as been offered by other countries in the region (see Figure 7).

Figure 7: Tax Regulation for REITs in the region

Country	Tax transparency	Local Investor	Foreign Investor		Comments
			Corporate	Individual	
Australia	YES (company components of stapled securities taxed at corporation rate of 30%)	0%(1)	15% (2)	15%	(1) LPTs are flow through tax vehicles for any income distributed to unit holders. In the hands of unit holders distributions have a component of tax deferral and effective tax rates depend on individual circumstances. (2) Withholding rates vary depending on tax agreements with other countries (0-30%).
Japan	YES	0%(3)	5-10%(5),(6)	10%(4),(6)	(3) J-REITs are exempt from taxation if they distribute over 90% of profits as dividends. (4) From 1 April 2008, withholding tax for individuals will increase to 20%. (5) 50% reduction may apply for corporate investors, if they own more than 50% of the voting stock. (6) Reduced rates may also apply under tax treaties.
Singapore	YES	0%(7)	10%(8)	0%	(7) Min. 90% of profits must be distributed to unit holders to obtain the tax transparent status. Undistributed income will be taxed at 20%.
Hong Kong	NO(8)	0%(8)	0%	0%	(8) REIT profits are taxed at the corporate tax rate (17.5%), while dividends and capital gains are tax free in HK.
Malaysia	YES	0%(9)	28%	28%	(9) Incomes distributed to unit holders are tax free although any undistributed income is taxed at 28%. Accumulated income that has been taxed and later distributed is eligible for tax credits in the hands of unit holders

Source: Macquarie Research, April 2006.

In January 2005, the SC issued the new Guidelines on Real Estate Investment Trusts (REIT Guidelines) to replace the PTF Guidelines issued in 2002. Key changes include exemption of real property gain tax and stamp duty on properties transferred to REITs. Figure 8 shows the comparison between the PTF and REIT Guidelines.

Figure 8: Comparison between REIT and PTF Guidelines

	PTF (Old)	REIT (New)
Management co. (MC)	Must be Public Company	Private or Public Company
Foreign ownership in MC	Up to 30%	Up to 49%
Leasehold assets	Remaining lease period of at least 60 years	No minimum lease period
Borrowing limit	Up to 30% of total assets	Up to 50% of total assets
Encumbered property	Must be free from encumbrances unless with SC's approval	May include property encumbered by financial institution
Franked dividend / net rental	Taxable with underlying credit available	Taxable with no underlying. Withholding tax of 28% for non-residents.

Source: Securities Commission, Malaysia.

The refined guidelines and the re-branding of PTFs as REITs have led to increased interest in the Malaysian REIT market, locally and internationally, although there remain ownership restrictions that prevent 100% foreign ownership of REIT managers. At August 2006, an additional five REITs including one Islamic REIT were listed in KLSE; with a market capitalisation of US$653.63 million; namely Axis REIT, Starhill REIT, UOA REIT, Tower REIT and Al-'Aqar KPJ REIT. Figure 9 shows the property portfolio of REITs in Malaysia.

Figure 9: Property Portfolio of REITs in Malaysia (as of August 2006)

Conventional PTFs	KLSE/ Bursa Malaysia Listing	Property name and location	Property type	Total asset value (RM m)		Total market cap (RM m)
AmFirst Property Trust (AMFPT)	28 September 1989	AmBank Group Building, KL	Office		180.00	184.07
		AmBank Group Leadership Centre, KL	Office		19.00	
		Menara Merais, Petaling Jaya, Selangor	Office		57.10	
				Total:	256.10	
First Malaysia Property Trust (FMPT)	23 November 1989 (delisted July 2002)					
Amanah Harta Tanah PNB (AHP)	28 December 1990	Plaza IBM, Taman Tun Dr. Ismail, KL	Office		69.60	74.00
		Bangunan AHP, Taman Tun Dr. Ismail, KL	Commercial		37.00	
		Seri impian, Taman Setiawangsa, KL	Office		9.00	
		4-storey shop house in Kuantan, Pahang	Shop house		0.91	
		Strata shop office in Butterworth, Penang	Shop office		0.88	
		Strata shop office in Asia City, Kota Kinabalu, Sabah	Shop office		1.25	
		3-storey shop house in Taman Tun Dr. Ismail, KL	Shop house		1.38	
		2 units of a 4-storey shop office, Pusat Bandar Melawati, KL	Shop office		2.10	
		4-storey shop office, Pusat Bandar Melawati, KL	Shop office		0.96	
		4-storey shop house, Miri, Sarawak	Shop house		0.82	
		3-storey shop house, Melaka	Shop house		0.47	
		Shop office, Kangar Perlis	Shop office		0.44	
		Shop office, Alor Setar, Kedah	Shop office		0.46	
		Shop office, Jalan Rubber, Kuching, Sarawak	Shop office		1.09	
				Total:	126.36	
Amanah Harta Tanah PNB 2 (AHP2)	25 March 1997	Bangunan Mayban Trust, Penang	Office		16.50	44.50
		Bangunan Mayban Trust, Ipoh	Office		18.30	
		5-storey building at Medan Tuanku, KL	Office		8.80	
previously known as MPTF-Mayban		Plaza Mayban Trust, KL	Office		9.30	
Property Trust Fund		Bangunan TAR, KL	Office		12.50	
				Total:	65.40	
Conventional REITs						
Axis REIT (AXREIT)	3 August 2005	Menara Axis, Petaling Jaya, Selangor	Commercial		80.00	370.62
		Crystal Plaza, Petaling Jaya, Selangor	Commercial		65.00	
		Axis Business Park, Petaling Jaya, Selangor	Office & Warehouse		93.00	
		Axis Plaza, Shah Alam, Selangor	Office & Warehouse		26.00	
		Infinite Centre, Petaling Jaya, Selangor	Office & Warehouse		32.00	
		Kompleks Kemajuan, Petaling Jaya, Selangor	Office & Warehouse		36.20	
		Kayangan Depot, Shah Alam, Selangor	Office Warehouse		18.20	
		Wisma Bintang, Petaling Jaya, Selangor	Office & Workshop		36.00	
		Axis North Port Logistics Centre 1, Port Klang, Selangor	Warehouse		13.50	
				Total:	399.90	

Conventional REITs	KLSE/ Bursa Malaysia Listing	Property name and location	Property type		Total asset value (RM m)	Total market cap (RM m)
Starhill REIT (STAREIT)	16 December 2005	Lot 10 Property, KL	Shopping Centre		341.00	925.60
		Starhill Gallery, KL	Shopping Centre		480.00	
		JW Marriott Hotel, KL	Hotel		329.00	
				Total:	1,150.00	
UOA REIT (UOAREIT)	30 December 2005	UOA Centre Parcels, KL	Office		58.40	246.24
		UOA II Parcels, KL	Retail and office		189.10	
		UOA Damansara, KL	Office		76.40	
				Total:	323.90	
Tower REIT (TWRREIT)	12 April 2006	HP Towers, KL	Office		135.00	218.50
		Menara HLA, KL	Office		228.00	
				Total:	363.00	
Islamic REIT						
Al-‘Aqar KPJ REIT (ALAQAR)	10 August 2006	Ampang Puteri Specialist Hospital Building, Ampang, Selangor	Hospital		128.80	336.60
		Damansara Specialist Hospital Building, Petaling Jaya, Selangor	Hospital		107.50	
		Johor Specialist Hospital Building, Johor Bahru, Johor	Hospital		75.30	
		Ipoh Specialist Hospital Building, Ipoh, Perak	Hospital		69.00	
		Puteri Specialist Hospital Building, Johor Bahru, Johor	Hospital		39.00	
		Selangor Medical Centre Building, Shah Alam, Selangor	Hospital		61.40	
				Total:	481.00	
Total Market Value					***3,165.66***	***2400.13***

Source: PTF and REIT Annual Reports, Datastream (US 1= RM 3.6720).

DEVELOPMENT OF ISLAMIC REITs IN MALAYSIA

An Islamic REIT is a form of ethical investment. It differs to the conventional REIT system as its framework is subject to the Islamic law principle. Among Muslim investors, this is known as the *Sharia* principle. Islamic law principle prohibits engaging with *haram* (religiously non-permissible) activities which involves either products or services but allows halal (religiously permissible) activities. For various reasons, an activity is labelled *haram* as it is considered to be harmful and destructive.

Currently, Islamic assets are burgeoning and it is estimated to be worth between US$200 billion to US$500 billion worldwide. At present, Malaysia is the Islamic financial hub for the South Asian region. According to credit-ratings agency Moody's Investors Service, Malaysia's Islamic bond market is the largest in the world, accounting to US$30 billion of the US$41 billion in Islamic bonds issued since 1996. In Malaysia, the financial system practices the dual finance system whereby the Islamic and conventional system work together. The Islamic finance system in Malaysia has been long established since 1983 and is widely acceptable by Muslims and non-Muslims locally and internationally. It has gained investors confidence for a promising investment return. With increasing awareness and growth of oil wealth, particularly in terms of attracting significant capital flows from other Islamic countries (eg: Middle East), there has been a strong demand for more innovative and competitive product from the Islamic financial industry.

Malaysia has taken the first step to issue *Sharia* guidelines for Islamic REITs in November 2005 which was published by the Syariah Advisory Council (SAC) of the Securities Commission (SC). It is a requirement that every Islamic financial institution that offers Islamic products and services establish a *Sharia* advisory committee/consultants to advise them and to ensure that the operations and activities comply with *Sharia* principles. All such Islamic structures will be certified by the *Sharia* Board, which comprises a panel of experts who are drawn from respected *Sharia* scholars with the expertise in Islamic law.

In the Malaysian Islamic REIT context, every single property transaction will have to be scrutinized by the SAC to ensure full compliance with Islamic principles. Therefore, all properties and tenant and subleasing have to be screened and approved by SAC. The development of Islamic REIT guidelines compliments the SC’s guidelines on REITs in Malaysia that were issued on January 2005. According to these guidelines, if an Islamic REIT would be introduced, it should be structured to compliment both the conventional and Islamic REIT guidelines.

According to the guidelines, an Islamic REIT is permitted to own or purchase property in which the tenants operate mixed activities that are *halal* and *haram*, but with restrictions. In a situation where the property has tenants operating *haram* activities, the fund manager needs to perform some additional compliance assessments before acquiring the property for an Islamic REIT. They need to ensure that the total rental ratio from *haram* activities to the total turnover of the Islamic REIT in the current financial year should not exceed 20 percent. Rental activities that are classified as *haram* as decided by the SAC are:

- Manufacturing or sale of *haram* products (i.e pork products, tobacco, alcoholic liquor, arms and ammunitions).
- Entertainment activities- cinema, pornography and any other obscene materials, hotels and resorts.
- Gambling.
- Conventional insurance companies.
- Stockbroking or share trading in non-*Sharia* compliant securities.
- Banks and financial institutions with *riba* (interest) base services.

If it does exceed 20 percent, the SAC will advise against investing in such a property. The fund manager needs to be well-versed in differentiating *halal* and *haram* activities. In addition, the manager of an Islamic REIT has to ensure that all forms of investment, deposit and financing instruments comply with the *Sharia* principles. Besides that, it has to use Islamic insurance to insure its property. However, conventional insurance is acceptable if Islamic insurance is unavailable.

An Islamic REIT is also not permitted to own a property in which all the tenants operate only *haram* activities. It cannot be put into an Islamic REIT even if the total rental complies with the 20% benchmark. In the case of accepting new tenants, tenants who operate fully *haram* activities will not be allowed. Figure 10 shows the comparison between Islamic and Conventional REIT.

Figure 10: Comparison between Islamic and Conventional REIT

Items	Islamic	Conventional
Issuance process	Must be approved by *Sharia* scholars and Securities Commission	Must be approved by Securities Commission only
Investors	Both conventional and Islamic investors	Only conventional investors
Property tenants	Tenants operating only *haram* activities will not be permitted. Restrictions applies when tenants operates mixed activities.	Tenants operating any activities

Source: Securities Commission, Malaysia.

In August 2006, the first Islamic REIT was successfully listed being the latest product which complements the existing mature industry of conventional REITs; the first such product in the world. The Islamic REIT will allow foreign investors especially from the Middle East to invest in Malaysia's property market without being associated with the direct ownership of the company. The first Islamic REIT, Al-'Aqar KPJ REIT comprises 6 properties in the hospital sector with a total asset value of US$92 namely; Ampang Puteri Specialist Hospital Building, Damansara Specialist Hospital Building, Johor Specialist Hospital Building, Ipoh Specialist Hospital Building, Puteri Specialist Hospital Building and Selangor Medical Centre Building. The Al-Aqar KPJ REIT, launched by KPJ Healthcare has a total asset value of US$130,991,285.

METHODOLOGY

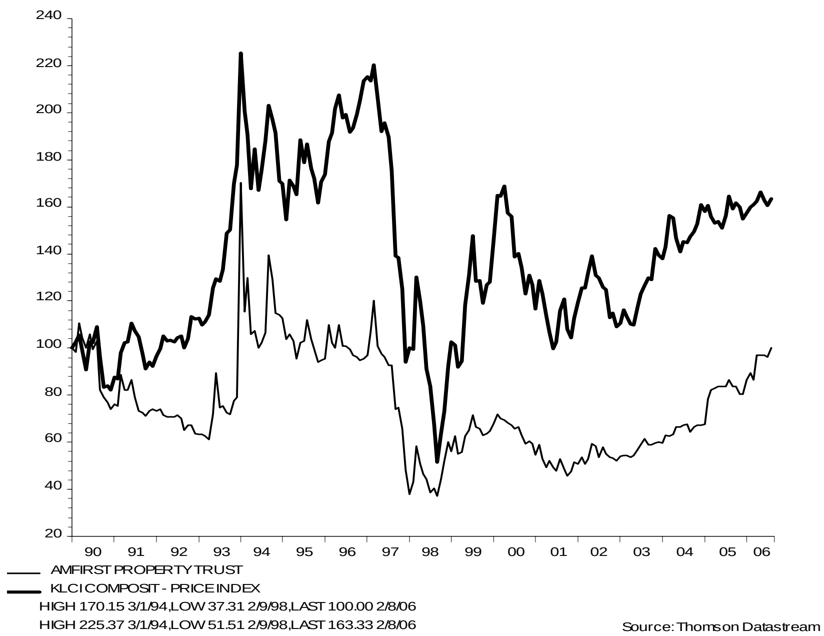
Analyses will be carried out for share price of Malaysian PTFs and REITs starting from 1989 till end of August 2006 respectively. This is to determine the underperformance and lack of investor support for PTFs and REITs in Malaysia. Since REITs was only recently listed in the Kuala Lumpur Stock Exchange in 2005 and followed by Islamic REIT in August 2006, this specific performance analysis for REITs in Malaysia will be over a short timeframe. The lack of a longer timeframe sees the standard performance analyses procedures of risk-adjusted returns and inter-asset correlations unable to be effectively implemented. As such the analyses at this stage are limited to assessing share price variations over this period and benchmarking this against the overall KL stock market performance indicators (i.e.: KLCI).

This research will also analyse the performance of Malaysian PTFs and REITs against the Malaysian stock market, Kuala Lumpur Composite index (KLCI). The share price index and the KLCI have been rebased at base date = 100. Thus a value of 30 indicates that the index was initially 70% lower and a reading of 180 represents an 80% increase since the base date. This way, it is easy to calculate the percentage differences from a base value of 100 and to compare the changes on percentage basis.

RESULTS AND DISCUSSIONS

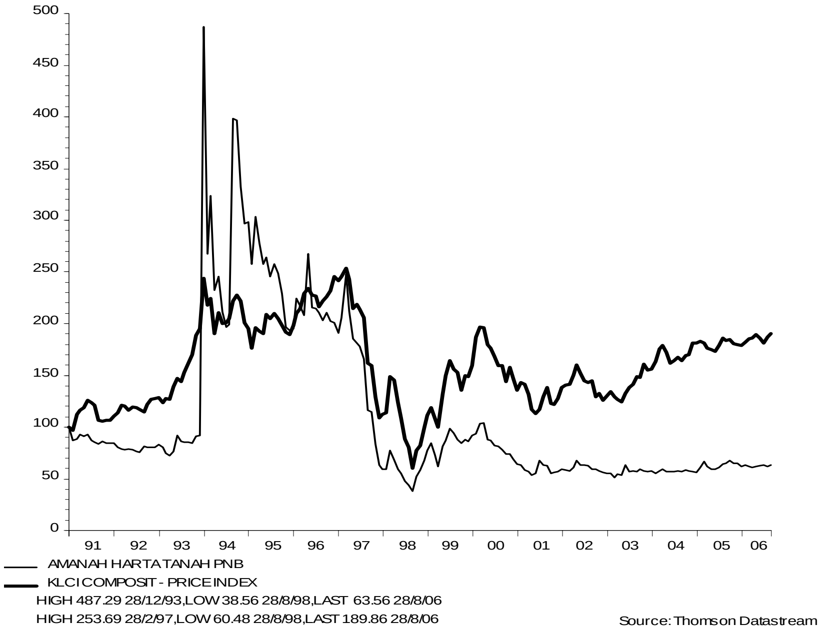
Apart from the lack of investor's knowledge to the new introduction of PTFs, the global economic uncertainties and the restrictive guidelines has been a barrier to the performance of PTFs and REITs in Malaysia. Figure 11 indicates the weak performance of AMFPT against KLCI. The KLCI outperformed the trust continuously since 1991 until now. It seems that the Malaysian stock market was highly preferred as the growth of PTFs was much reliant to high occupancy and rental rates.

Figure 11: Comparison of AMFPT with KLCI (Base date = 2 January 1990)



However, the prices of AHP during the period of 1994 and 1995 have managed to outperform the KLCI although after 1995 the trust starts to loose momentum. Figure 12 presents the price performance of AMFPT against KLCI. The significant increase was highly supported by the non-prime properties injected. This proves that PTFs may not necessarily acquire best assets in best locations but the management needs to know how to enhance and make the trust more attractive to investors.

Figure 12: Comparison of AHP with KLCI (Base date = 28 December 1990)



Amongst the 3 PTFs, AHP2 remains out of favour as investors worry over the management which have caused the long period of low occupancy rates. Figure 13 represents the volatile performance of AHP2 over 1990-2006, along with the KLCI. The trust appears to fall much further in the Asian economic crisis period of 1997 and 1998 and gaining recovery during the post crisis over the period of 1999 and 2000.

Figure 13: Comparison of AHP2 with KLCI (Base date = 25 March 1997)

Too much concentration on the office and retail sector has contributed to the lacklustre performance of PTFs. It is vital that a property portfolio is properly diversified especially in an unpredictable market condition. Focusing on one certain aspect will definitely affect the performance of REITs.

To help address this issue, different types of properties in different locations lead to different results. Learning from the regional market, investors will loose interest if the trust did not acquire new properties to the existing portfolio.

On a positive side, efforts have been taken to increase investor's interest to this industry especially with the minimisation of consumer spending following the increased price of oil and interest rate. To stimulate the REIT market, borrowing limit has been increased, although this has led to increase expenditure related on the transferred property to REITs. Limitation to foreigners still exists. A more improve guidelines on REITs has encourage demand ahead.

Axis REIT reflects the strong interest by investors to the new re-branding of PTFs to REITs, with the revelation of mixed assets as industrial and office space acquired to the trust. Of the four REITs, Axis REIT gain the highest price since listing, rising 55 sen over its initial public offer price (IPO) of RM1.25 (see figure 14).

Figure 14: REITs performance since IPO (as of 31 August 2006)

	IPO Price (RM)	Current Price (RM)	Change in Share Price (%)
Axis REIT	1.25	1.8	55
Starhill REIT	1.03	0.89	-14
UOA REIT	1.18	1.11	-7
Tower REIT	1.05	0.91	-14
Al-'Aqar KPJ REIT	0.95	0.99	4

Source: Datastream and author's compilation.

In comparison to other REITs, Axis REIT had acquired new properties since it went public. The good management has driven the growth of the trust through acquisitions and increase rental incomes. Figure 15 and 16 shows the considerable volatility of Axis REIT share price performance. The price is expected to improve further in the future together with the growth of the industry.

Figure 15: Share Price of AXIS REIT (Base date = 2 August 2005)

Figure 16: Share Price of AXIS REIT (Base date = 3 August 2005)

Good management strategies with mixed quality assets in prime location have supported the trust to perform better in comparison to other REITs. Figure 17 and 18 shows the performance of Axis REIT against KLCI, with the momentum constantly increasing and outperforming the KLCI. The growth comes together with an increased interest from foreign investors and retirees. It is likely that most investors prefer prime properties as they are likely to generate income easier.

Figure 17: Comparison of AXIS REIT with KLCI (Base date = 2 August 2005)

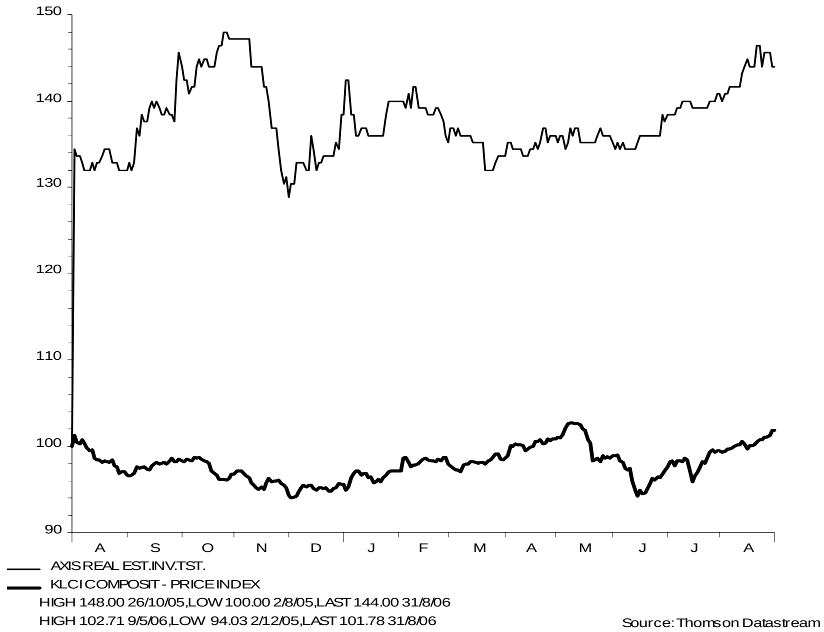


Figure 18: Comparison of AXIS REIT with KLCI (Base date = 3 August 2005)

Meanwhile, the performance of Starhill REIT (the first international REIT) which is mainly focused on the retail sector has been downcast by raising interest rates because of its high valuations. Underpinned by the tax levied to foreign investors and no minimum payout ratio in the guidelines, these have been constraining to the trusts development. Commenting on the property type, the risk of a retail property is generally higher in comparison to other property type especially in prime area as it is dependent on consumer spending and tourist arrivals. According to Jones Lang LaSalle report, the occupancy and rental rates have yet to reach their previous level pre-1997 (see figure 19).

Figure 19: Kuala Lumpur Retail Market

Key Indicators	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Vacancy rate (% pa)	NA	NA	3.3	9.0	11.8	14.2	14.1	12.6	12.6	16.6	18.9	15.3
Net rent (RM psm pa)	2,015	2,454	2,454	2,454	1,956	1,511	1,504	1,521	1,521	1,521	1,567	1,698

Source: Jones Lang LaSalle report and author's compilation.

Higher interest rates are likely to continue deteriorating the performance of this trust. During the period under review, Starhill REITs were traded at prices ranging between RM1.06 sen and 88 sen (see figure 20). Investors continue to lack interest and opt for other investment alternatives which offer more attractive returns. Figure 21 shows the comparison of Starhill REIT with KLCI. The trust has lost momentum on concerns over the outlook for higher interest rates.

Figure 20: Share Price of STARHILL REIT with KLCI (Base date = 16 December 2005)

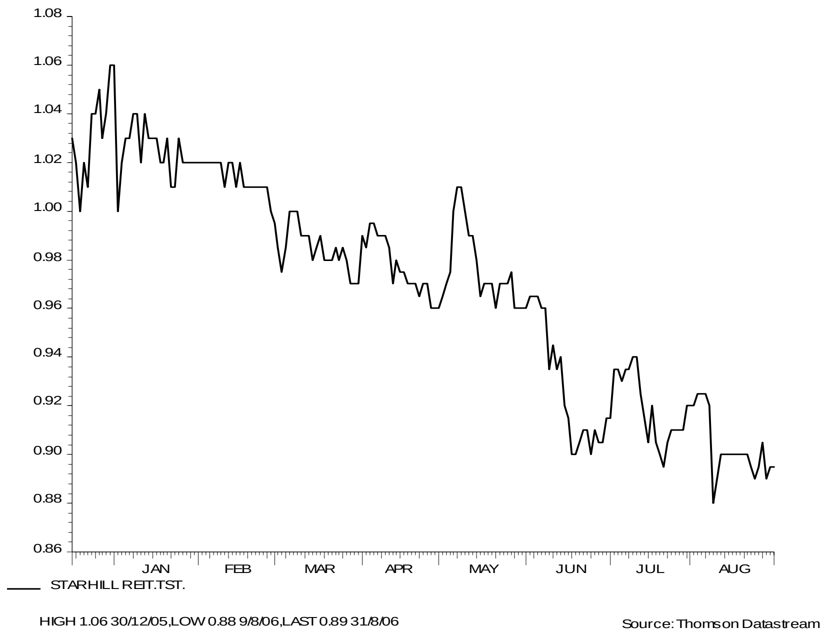


Figure 21: Comparison of STARHILL REIT with KLCI (Base date = 16 December 2005)

In contrast, Figure 22 shows the share price performance of UOA REIT. The trust is currently valued at RM1.11, down 7 sen from its IPO of RM1.18 which performed better in comparison to Starhill REIT and Tower REIT. With a good management and a mix property type of office and retail space it is likely that the trust has a potential to exceed in the future. This is mainly because of the trust has a good tenant mix of nearly 200 tenants and the lease period is at two years with an option to renew. These has seems to be the attraction in the eyes of investors. A loss of one key tenant may not give a huge impact to the occupancy rate. Figure 23 shows that the trust is starting to loose momentum but this could reverse.

Figure 22: Share Price of UOA REIT (Base date = 29 December 2005)

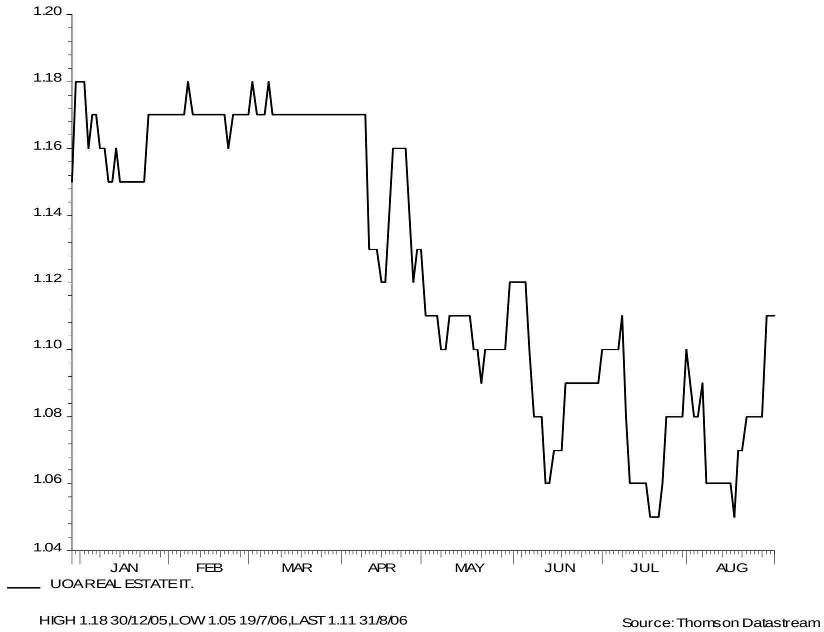
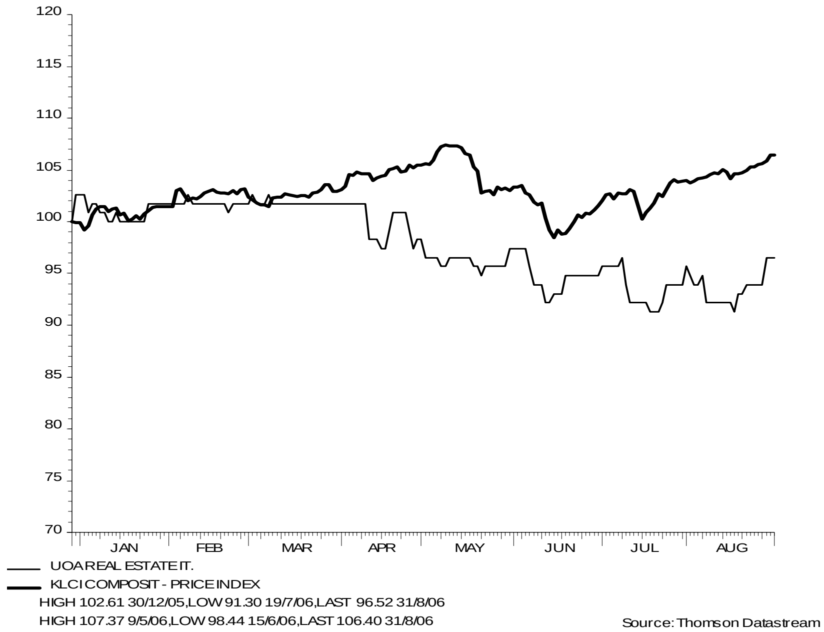


Figure 23: Comparison of UOA REIT with KLCI (Base date = 29 December 2005)



The office sector in prime areas is likely to have a strong growth prospect in the future. Constrains have been imposed by the government on the establishment of new office space as a result of an oversupply after the 1997 Asian financial crisis. Hence, the new office supply in Kuala Lumpur has been limited since 2000. Meanwhile, according to Jones Lang LaSalle report while occupancy and rental rates have yet to reach their previous level pre-1997, the rates is improving and slowly increasing (see figure 24).

Figure 24: Kuala Lumpur: CBD & Golden Triangle Office Market

Key Indicators	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**
Vacancy rate (% pa)	7.1	5.7	2.8	2.5	12.8	17.1	17.7	18.5	20	19.9	18.8	17.3
Net rent (RM psm pa)	438	437	437	437	336	287	291	297	275	240	293	316

Source: Jones Lang LaSalle report and author's compilation.

However, there has been a continuous downward trend since the debut of Tower REIT following the slowdown of the economy (see figure 25 and 26). The trust should be more competitive by injecting new assets into their portfolios. Therefore the rental incomes will grow or at least be maintained.

Figure 25: Share Price of TOWER REIT (Base date = 11 April 2006)

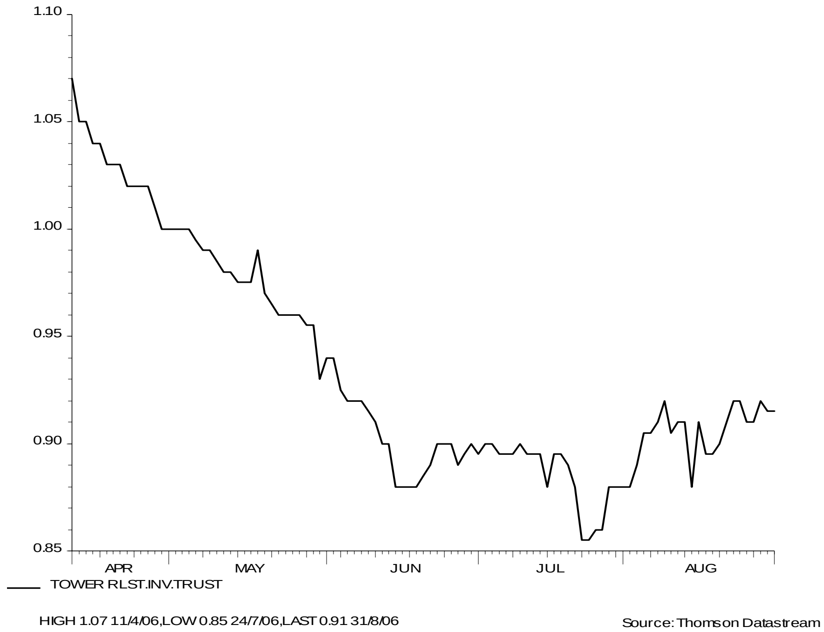


Figure 26: Comparison of TOWER REIT with KLCI (Base date = 11 April 2006)

As at 31 August 2006, the current price for Al-‘Aqar KPJ REIT is at 99 sen, a 4 sen premium on its issue price IPO of 95 sen. It recorded the second highest volume in comparison to other REITs. Figure 27 depicts the price performance for Al-‘Aqar KPJ REIT. Investors seem to be encouraged by the introduction of this new investment vehicle. Although the current market condition is still at risk with the hike of interest rates, this did not stop the first debut of Islamic REIT to perform. Furthermore, it proves that the difference in type of property and location have certainly made a major impact to investors decision making. Figure 28 shows that the trust outperformed the KLCI and is slowly gaining momentum with an increase of 6.32% since its base date.

Figure 27: Share Price of Al-'AQAR KPJ REIT (Base date = 9 August 2006)

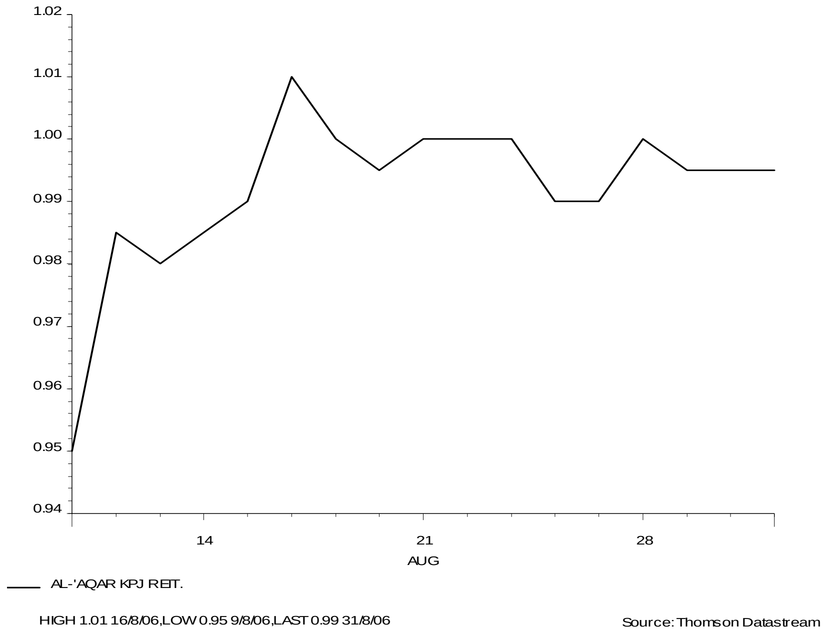
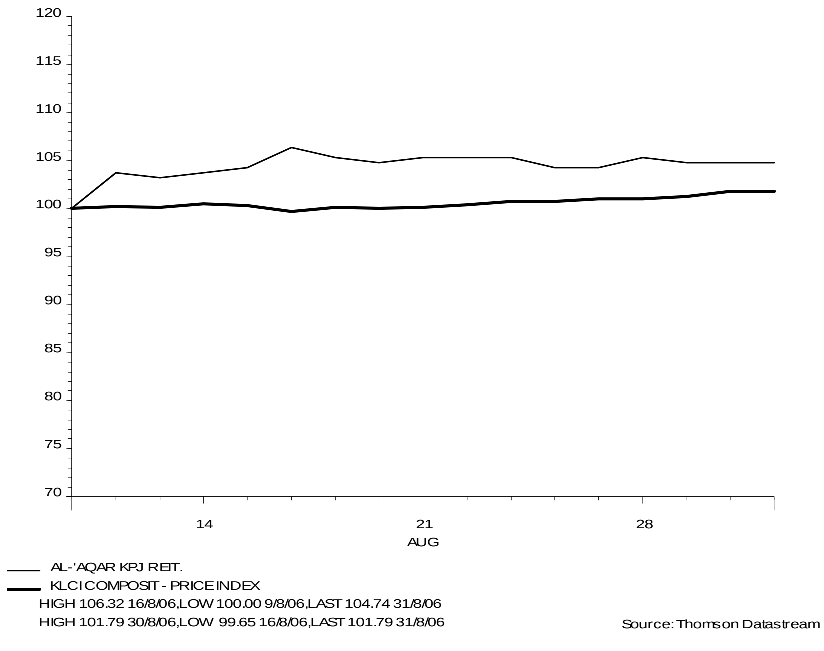


Figure 28: Comparison of Al-'AQAR KPJ REIT with KLCI (Base date = 9 August 2006)



IMPLICATIONS

According to the Jones Lang LaSalle 2006 Global Real Estate Transparency Index (JLL, 2006a), Malaysia ranked 22 in the world's list and is considered as a transparent real estate market, with a moderate improvement in transparency from 2004 to 2006. This is partly attributable to the development of REITs in Malaysia. Overall rental rates of prime office and retail buildings in Kuala Lumpur remain stable with upward projections in the short term. The investment yield for prime

offices and retail range between 5-7.5% and 8-11% respectively, while vacancy rates continued moving down, particularly within prime offices and retail (JLL, 2006b).

The short history in data is not nearly long enough in term to analyse investment returns comparable to those achievable regional markets. Despite anticipated rising interest rates, the share price is expected to pick up again following improvements to the guidelines in the future. The Malaysian REIT is destined to grow further with the right strategy. To sustain in the challenging environment of investment, parties involved need to revive and improve the REITs industry: Suggestions are as follows:

- Generate more interest to investors by education.
- Acquire quality type property and in strategic location.
- More relaxation to the current guidelines-possibility of a new tax structure.
- Management strength needs to be enhanced.

However, there is number of issues that could limit the introduction for Islamic REITs.

- Given the constraints and the limitations given by the Islamic law, would companies choose to issue an Islamic REIT? Given Islamic law restrictions this would make Islamic REITs less desirable compared to conventional REITs. Policymakers need to tackle the regulatory framework.

- Efforts should be made to increase the capacity of *Sharia* compliant buildings.

- Attaining standardised guidelines for Islamic REITs should be generally acceptable to all Muslims investors around the world.

- The need to assign a specific committee to monitor every action made for an Islamic REIT.

- To make Islamic market a success, *Sharia* expertise should address the needs of Muslim investors worldwide and to not just cater for investors in the Gulf region but target the local market as well.

- Educating investors-experts need to raise the level of understanding, awareness and acceptance of the Islamic REIT.

To make Islamic REIT a complete success, the regulators should consider a global marketing strategy. With the introduction of Islamic REITs, REITs will play an important role in Malaysian real estate market and it is likely that the Islamic compliant property market is poised to become significant within the global financial markets.

Future research will be conducted which will examine the development, performance and impact of Malaysian REITs in the local and global REIT market. Currently, Malaysian REITs performance series are not available in Malaysia. An index that tracks the performance of Malaysian REITs will be developed. Previous research has shown that to analyse real estate as an asset class, an appropriate index must be available to compare it with other asset classes (e.g., Geltner, 1989; Geltner, 1993; Giliberto, 1990; Liang and Webb, 1996; Firstenberg, Ross and Zisler, 1998). This will be useful to assess performance and diversification benefits. Similarly, a longer time period for REITs in Malaysia will see significantly more data available for a fuller investment analysis to assess the risk-adjusted returns and portfolio diversification benefits of REITs in Malaysia; particularly compared to the other major asset classes in Malaysia.

Initial analyses will also be conducted over 2005 – 2007 for Malaysian REITs to provide the basis for future research regarding the performance and strategic development of Malaysian REITs and

Islamic REIT as a successful REIT product in Asia. The associated investors' surveys will see a much richer and informed analysis than that just provided by the empirical performance analyses. Personal interviews will also be conducted and a survey in the form of a questionnaire will also be distributed to surveys and assess investor attitudes to Malaysian REITS and Islamic REITS both with Malaysian and international investors. As there are more Malaysian REITs to come, the on-going research will be significant to the successful growth of Malaysian REIT.

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